



## STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

Date Amended:	<b>5/17/01</b>	Bill No:	<b>AB 1433</b>
Tax:	<b>Property</b>	Author:	<b>Horton</b>
Board Position:	<b>Support - Board Sponsored</b>	Related Bills:	

### **BILL SUMMARY**

This bill would provide all taxpayers with equivalent assessment appeal rights after a property tax audit.

### **ANALYSIS**

#### **Current Law**

Revenue and Taxation Code Section 469 requires county assessors to audit, at least once every four years, the books and records of any taxpayer engaged in a profession, trade, or business, if the taxpayer has assessable trade fixtures and business tangible personal property valued at \$400,000 or more. These statutorily required audits are commonly referred to as “mandatory audits.” Additionally, the assessor may audit the books and records of taxpayers with holdings below \$400,000 in value under the authority of Revenue and Taxation Code Section 470. These audits are referred to as “nonmandatory audits.” Generally, assessors perform both mandatory and nonmandatory audits to ensure that the audit program includes a representative sample of all sizes and types of property.

Section 469, in addition to requiring the periodic audit of specified taxpayers, specifies that when a mandatory audit has been conducted and the audit has “disclosed property subject to an escape assessment,” then the original assessment of all the property of the assessee at that location is open to appeal for the year of the escape, except property for which the value has been previously equalized (i.e. a previous assessment appeal on the property was heard and decided). In contrast, when a nonmandatory audit is conducted and an escape assessment is made as a result of the audit, the taxpayer may appeal only the property subject to escape assessment.

#### **Proposed Law**

This bill would amend Section 469 of the Revenue and Taxation Code to provide taxpayers subject to nonmandatory audits the identical assessment appeal rights currently provided to taxpayers after mandatory audits.

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### In General

Revenue and Taxation Code Section 469 requires that an assessor perform periodic audits (once every four years) of the books and records of any business with taxable personal property and fixtures valued at \$400,000 or more.

Generally, after the assessor audits the taxpayer, there are three possible outcomes:

1. **No Change.** The audit results in “no change” in the original value placed on the property. There are two ways an audit can result in “no change:”
  - a. No changes were discovered.
  - b. Any changes discovered were “netted out,” by overassessments offsetting underassessments. (For efficiency purposes, overassessments can offset underassessments in calculating the amount of taxes due or owing.)
2. **Refunds.** A “net overassessment” is discovered, resulting in a refund of property taxes previously paid.
3. **Escape Assessments.** A “net underassessment” is discovered, resulting in an “escape assessment” and additional taxes due.

Section 469 and Section 1605 specify that, when an audit has been conducted, and the audit “disclosed property subject to an escape assessment,” then all the property of the taxpayer at that location is open to appeal for the year of the escape, except property whose value was determined pursuant to a previous assessment appeal. “All the property,” means all real and personal property.

The phrase “subject to an escape assessment” is without statutory definition. It has been the Board’s longstanding position that the phrase “subject to” gives the assessee the right to appeal, regardless of whether the assessor actually enrolls an escape assessment. In other words, for any year in which the assessor determined that some property was either underassessed or not assessed, the taxpayer is entitled to an appeal hearing on the entire property whether or not a tax bill is ultimately issued. An Attorney General’s opinion, 97-315, concurs with the Board’s interpretation on this matter.

Senate Bill 1752 (Chap. 732, Stats. 1978; Ayala) added the provision that provides when any mandatory audit discloses property subject to an escape assessment, then all the property of the taxpayer at that location is open to appeal for the year of the escape, except property the value of which was determined pursuant to a previous assessment appeal. The Taxation Section of the California State Bar was the sponsor of Senate Bill 1752. In an August 31, 1978, letter to then Governor Brown, the State Bar outlined the purpose of their legislation. That letter reads in pertinent part:

“The bill is needed because many taxpayers do not protest assessments when the overall assessment at a business premises seems fair, even though some components are over-assessed and some under-assessed. Then, years later the assessor by reason of audit, proposes an escape assessment for the under-

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assessed component. Under present law, the taxpayer has no redress for the over-assessment component at the late date of the proposed escape assessment.

The bill has a *de minimis* or no costs to local government and was not opposed by the Legislature. It is particularly important due to the passage of Proposition 13 because assessors now have to review 1975-76 assessments of real property.

In that year (1975-76), many fixtures and heavy machinery were misclassified as personal property, either by the taxpayer or assessor. It did not make a difference in tax then because both real and personal property were taxed at virtually the same rate. Under Proposition 13, real property is to be rolled back to its 1975-76 value. Hence if the assessor in an audit wants to reclassify property assessed as real property in 1975-76 year as being personal property, the taxpayer may need the whole assessment reviewed in order to have fair and equal treatment under the property tax law.”

### Background

The staff of the Board of Equalization has been in the process of drafting a proposed regulation, Property Tax Rule 305.3, which would interpret the provisions of Section 469 relating to assessment appeal rights and appeals boards’ jurisdiction to equalize the original assessment of all property of the assessee at the location of the profession, trade, or business for the year of the mandatory audit. In preparing a regulation, Board staff first meet with interested parties to discuss issues related to the proposed regulation and reach consensus where possible. When consensus on an issue is not reached, the issue is presented by staff to the Members of the Board of Equalization meeting as the Property Tax Committee for resolution.

On November 1, 2000, the Board of Equalization’s Property Tax Committee decided various unresolved issues necessary to provide staff with direction in drafting Rule 305.3. One issue addressed was whether the appeal provisions contained in Section 469 applied only to mandatory audits or all audits. (Issue Paper 00-41) <http://www.boe.ca.gov/proptaxes/ptcmeetings00.htm> The Committee concluded that the appeal provisions contained in Revenue and Taxation Code Section 469 applied only to mandatory audits, but that legislation should be sought to extend the appeal provisions to nonmandatory audits.

### COMMENTS

1. **Sponsor and Purpose.** This bill is sponsored by the Board of Equalization. Its purpose is to eliminate the current disparity in treatment between taxpayers based on whether or not their audit was mandated by law. This bill would guarantee that all taxpayers who are audited by a county assessor, regardless of the value of their assessable trade fixtures and business tangible personal property, would have the same opportunity to file an application for equalization of the original assessment of

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all property at the location of the business, trade, or profession for the year of the audit when the result of any audit discloses property subject to escape assessment.

2. **Amendments.** The May 17 amendment redrafts the bill to amend existing Section 469 to accomplish the same purpose rather than moving language from Section 469 into a new section of code and then amending various sections of law to update cross references. This change was made to address concerns expressed by interested parties that it is preferable to amend Section 469 to ensure that there are no unintended consequences of moving the language into a separate section of code, since Section 469 has been subject to recent litigation.
3. **Appeal Timing – During the Annual Filing Period or After an Audit.** Ordinarily, a taxpayer who does not file an appeal application within the prescribed annual filing period from July 2 through September 15 for a particular tax year is thereafter precluded from appealing the value of their property for that year. Notwithstanding this general provision, appeals are permitted for certain prior tax years after a mandatory audit, if the audit discovers property subject to an escape assessment. For instance, if a business taxpayer does not file an appeal on its 1998-1999 assessed value between July 2, 1998 and September 15, 1998, the assessed value of its property for the 1998-99 tax year is generally final for that year and the taxpayer may not later challenge the value determined. However, if a mandatory audit of the taxpayer's property for the 1998-99 tax year is completed in 2001 and the audit discovers property subject to an escape assessment for the 1998-99 tax year, then in 2001, the business could appeal the original assessment of all property at the location for the 1998-99 tax year. Of course, generally it would be in the best interest of a business to file an appeal in 1998 if it disagreed with the value set by the assessor.
4. **What is the difference in appeal rights?** A taxpayer subject to a nonmandatory audit (generally smaller businesses) may appeal only the value of the property subject to escape assessment. A taxpayer subject to a mandatory audit (generally larger businesses) may appeal the original assessment of all the property at the location of the business, trade or profession in addition to the specific property subject to escape assessment. For instance, if a nonmandatory audit disclosed that a particular piece of equipment was not assessed, the small business owner could only challenge the value of the specific piece of equipment as determined by the escape assessment. Conversely, a large business owner subject to a mandatory audit could appeal the original assessment of the land, building, and/or personal property in addition to the escape assessment of the particular piece of equipment.
5. **What is the rationale for permitting a taxpayer to appeal all the property rather than just the property subject to an escape assessment?** The purpose of opening the original assessment of the entire property to appeal is to protect taxpayers from misallocation of value within the total assessment. When an entire property is originally assessed, a taxpayer may agree with the value determined by the assessor for the entire property but may disagree with the allocation of the value among real and personal property. As a result, the taxpayer does not appeal the

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overall assessment, even though some components are overvalued and some undervalued. Years later, after an audit, the assessor could propose an escape assessment for the undervalued component but leave the overvalued component unchanged. By permitting the taxpayer to appeal the original assessment of all the property at the location, the county assessment appeals board has the power of oversight to ensure that the entire assessment (the original assessment and the escape assessment) is correct.

6. **There appears to be no supportable reason why larger businesses should have greater appeal rights than small business owners.** This bill would afford all taxpayers the same rights regardless of size.
7. **Supporters of equal appeal rights have noted that the disparity could create an incentive for an assessor to manipulate “nonmandatory audits” of larger businesses.** Specifically, it is stated that by limiting the application of the equalization provisions to mandatory audits, an assessor could perform a superficial mandatory audit with a no change result and later conduct a nonmandatory audit that discloses property subject to escape assessment. In that event, the taxpayer would have the right to appeal only the property for which an escape assessment has been made.
8. **Opponents of this measure dislike current law, and therefore oppose any expansion of it.** Opponents state that the ability to appeal after an audit is used by some taxpayers as a mechanism to attempt to receive retroactive reductions in value when the taxpayer had otherwise failed to file a timely appeal at the time the original assessment was made. Additionally, opponents believe that taxpayers should not be allowed the opportunity to appeal the value of all the property; rather they believe appeal rights should be limited to the value of the escaped property.

## **COST ESTIMATE**

With respect to property taxes, the Board would incur some minor absorbable costs in revising forms and updating Assessors' Handbooks.

## **REVENUE ESTIMATE**

Any revenue impact would stem from additional assessment appeals that could be filed on property other than the actual property subject to escape assessment. Appeals boards can increase, decrease, or maintain the value determined by the assessor. Thus, any loss or gain would be associated with the assessment appeals boards setting a value different than that established by the assessor. There is no measurable standard upon which to base an estimate of the outcome of assessment appeals decisions.

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